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Illustrations of "push down" accounting; Financial report survey, 31

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FINANCIAL REPORT SURVEY 31

Illustrations of "Push Down" Accounting

By Hortense Goodman, CPA
and
Leonard Lorensen, CPA

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Illustrations of "Push Down" Accounting

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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

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Illustrations of "Push Down" Accounting

PREFACE

This publication is the thirty-first in a series produced by the Institute's staff through use of the Institute's National Automated Accounting Research System (NAARS). Earlier publications in the series are listed on the inside cover of this publication.

The purpose of the series is to provide interested readers with examples of the application of technical pronouncements. It is believed that those who are confronted with problems in the application of pronouncements can benefit from seeing how others apply them in practice.

It is the intention to publish periodically similar compilations of information of current interest dealing with aspects of financial reporting.

The examples presented were selected from over twenty thousand annual reports stored in the NAARS computer data base.

This compilation presents only a limited number of examples and is not intended to encompass all aspects of the application of the pronouncements covered in this survey. Individuals with special application problems not illustrated in the survey may arrange for special computer searches of the NAARS data banks by contacting the Institute. Call (212) 575-6393.

The views expressed are solely those of the staff.

John Graves
Director, Technical Information Division

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SCOPE AND PURPOSE OF THE SURVEY

"PUSH DOWN" ACCOUNTING DEFINED

"Push down" accounting is the establishment of a new accounting and reporting basis for an entity in its separate financial statements, based on a purchase transaction in the voting stock of the entity that results in a substantial change in the ownership of the outstanding voting stock of the entity. The price of the stock to the new owners is "pushed down" to the entity and used to restate its assets and liabilities or include goodwill in its financial statements. If all of the voting stock is purchased, the assets and liabilities of the entity are restated so that the excess of the restated amounts of the assets over the restated amounts of the liabilities equals the purchase price of the stock.

Push down accounting is not discussed in any currently effective pronouncements that have been issued by the Financial Accounting Standards Board or its predecessors. The Securities and Exchange Commission, in Staff Accounting Bulletin No. 54, "Push Down Basis of Accounting Required in Certain Limited Circumstances," apparently permits, but does not require, push down accounting in financial statements filed with the Commission for an entity (entity S) of which at least a majority of the voting stock is acquired by another entity (entity P) whose financial statements are filed with the Commission. Push down accounting apparently is required for S if P acquires substantially all of S's voting stock and S has no liabilities represented by publicly traded debt instruments and no preferred stock outstanding. Staff Accounting Bulletin No. 54 is reproduced in Appendix A.

Arguments for and against push down accounting and problems in applying it are discussed in the issues paper of October 30, 1979 " 'Push Down' Accounting," which was prepared by the Task Force on Consolidation Problems of the AICPA Accounting Standards Division. The Issues Paper, without the appendix to it, is reproduced in Appendix B to this survey.

SOURCE OF ILLUSTRATIONS

The application of push down accounting requires considerable judgment. An accountant who is confronted with problems in applying push down accounting can benefit from learning how other accountants are applying it in practice. Accordingly, this publication presents excerpts from seven recently issued financial statements that illustrate its application.

The AICPA National Automated Accounting Research System (NAARS) was used to compile most of the information. Seven of the eight examples presented were selected from more than 20,000 reports to stockholders stored in the computer data base. One example (Child World, Inc.) was taken from a registration statement filed with the SEC.

II

PRESENTATION OF THE EXAMPLES

Eight examples of push down accounting are presented below. In seven of the examples, the company to which push down accounting was applied (the push down company) experienced the sale of all or a substantial majority of its voting stock. In the remaining example, Child World Inc., the push down company did not experience the sale of its voting stock, but the parent company of the push down company experienced the sale of all of its voting stock.

In all but two of the examples in which the push down company experienced the sale of its stock, all the stock sold was sold to a single company previously unrelated to the push down company. In one example, Princeville Development Corporation, all the stock sold was sold both to stockholders of the parent company of the push down company and parties previously unrelated to the push down company. In another example, Cincinnati Microwave, Inc., the stock sold was in substance sold to the push down company, which in substance borrowed the money used to buy it.

The independent auditors of three of the push down companies referred to push down accounting in their reports on the financial statements of the push down companies. The reports are included in the examples.

After the eight examples of push down accounting are presented, two examples are presented of companies that considered but rejected push down accounting.

Companies That Applied Push Down Accounting

CHILD WORLD, INC.
Notes to Consolidated Financial Statements
February 2, 1985

(1) Summary of Significant Accounting Policies

Cole National Corporation (Cole), through a wholly owned subsidiary, owns all of the outstanding stock of Child World, Inc. (the Company). The Company's fiscal year ends on the Saturday closest to January 31.

In September 1984, CNC Holding Corporation (Holding) through a wholly owned subsidiary, acquired by merger all of the outstanding stock of Cole; thus, the Company became a wholly owned indirect subsidiary of Holding. The accompanying financial statements include the accounts of the Company and its subsidiaries, after adjustment of the corresponding assets and liabilities to their estimated fair value to reflect a preliminary allocation of the Company's portion of the cost of the acquisition, commonly referred to as "push-down accounting." Reflected below is a summary of these adjustments:

Increase in	(in millions)
Cost in Excess of Net Assets of Purchased Business	$80.8
Net Property and Equipment and Leased Property Under Capital Leases	12.3
Inventories	4.8
Other Liabilities	.1

The assets and liabilities of the Company were previously adjusted to their estimated fair value in the acquisition of the Company by Cole National Corporation effective January 31, 1981.

For financial statement purposes, the acquisition, accounting for by the purchase method, is being reflected as having occurred on September 22, 1984, the end of the fiscal month. Accordingly, the results of operations and changes in financial position reflect the 19 week period ended February 2, 1985.

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CINCINNATI MICROWAVE, INC.

Management's Discussion and Analysis of Financial Condition and Results of Operations

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1. On June 17, 1983, a newly formed corporation wholly owned by James L. Jaeger, a founder of the Company who owned one-third of its then outstanding common shares, without par value ("Shares"), purchased the other two-thirds of the then outstanding Shares from the other two founders of the Company for an aggregate cash purchase price of $24,000,000. The corporation borrowed the funds used to purchase such Shares from two commercial banks. Immediately after the purchase, the corporation was merged into the Company (the "Merger"). As a result of the Merger, the Company acquired the Shares owned by the corporation and became obligated to repay the $24,000,000 which the corporation had borrowed to finance its purchase of such Shares.

2. The Merger, which was recorded as of June 26, 1983 for accounting purposes, was accounted for as a purchase whereunder part of the $24,000,000 acquisition cost of the Shares was allocated to the Company's assets (since such assets were deemed to be represented by the outstanding Shares) causing the value of such assets on the Company's books to be increased to two-thirds of their fair value as of June 26, 1983 since two-thirds of the outstanding Shares were acquired in the Merger; the balance of the acquisition cost was recorded as the excess of purchase price over fair value of the net assets acquired ("goodwill"). The financial information contained herein relating to the Company's net sales and profits for the nine-month period ended June 26, 1983 and the three-month period ended September 25, 1983 are presented separately due to the new basis of accounting which resulted from the Merger. No per share information is presented for any period prior to June 26, 1983 since such periods are not comparable to subsequent periods on a per share basis due to the large number of Shares which ceased to be outstanding as a result of the Merger.

Notes to Consolidated Financial Statements

Note 2—Acquisition of Shares through Merger and Basis of Presentation

On June 17, 1983, a new corporation, wholly-owned by an officer and director of the Company then owning one-third of the Company's common shares, purchased the remaining two-thirds of the Company's then outstanding common shares for $24,000,000 with funds borrowed from two commercial banks. The new corporation was then merged into the company. The merger was accounted for as a purchase whereby part of the acquisition cost of the common shares was allocated to the net assets acquired based on two-thirds of their fair value, and the balance was recorded as the excess of purchase price over fair value of net assets acquired. The transaction was recorded as of June 26, 1983 for accounting purposes. As of June 26, 1983, the remaining one-third of the Company's assets continued to be stated at pre-acquisition historical cost.

The Company successfully completed its initial public offering of 1,200,000 shares on December 13, 1983. The entire net proceeds of the offering were utilized to eliminate the remaining outstanding bank indebtedness. The accompanying consolidated statements of income for the nine-month period ended June 26, 1983 and the three month period ended September 25, 1983 are presented separately due to the new basis of accounting which resulted from the merger. Because of the merger, the financial information contained herein for periods subsequent to June 26, 1983 is not in every respect comparable to the financial information for periods ending on or prior to that date. Specifically, the differences are principally the result of depreciation of the additional cost allocated to property, plant and equipment, the amortization over fifteen years of the amounts allocated to identifiable intangible assets and the excess of the acquisition cost over fair value of net assets acquired in the merger. Additionally, salary and bonus expenses were reduced due to the departure of two of the Company's principal officers, new employment contracts and a modified bonus plan.

The following unaudited pro forma condensed results of operations for the year (52 weeks) ended September 25, 1983 are stated as if the merger had occurred on the first day of the period (000 omitted):

Net sales	$57,106
Net income	$10,015
Earnings per share (based on 10,080,000 shares outstanding)	$.99

Unaudited supplementary pro forma income per share before extraordinary item for the year ended September 25, 1983 is $1.02, computed by eliminating the interest expense, net of tax effect, on the indebtedness assumed by the Company in the merger and giving effect to the application of the net proceeds from the sale of the 1,200,000 shares to the repayment of the indebtedness. Unaudited supplementary pro forma net income per share for the year ended September 25, 1983 of $.93 gives effect to the write off of the unamortized balance of the loan origination fees as an extraordinary item.

FIRST DATA RESOURCES, INC.
Notes to Consolidated Financial Statements

1. The Company: Organization

First Data Resources Inc. (the Company) is engaged in one line of business: provision of on-line database information services utilizing its proprietary software systems and its telecommunications network to customers including financial institutions that issue MasterCard® and VISA® cards, merchandisers, and cable television systems.

American Express Company (Amexco) purchased 80% of the capital stock of the Company on January 10, 1980. Under a Stock Purchase Agreement entered into between the Company's stockholders and Amexco, the stockholders had options to sell and Amexco had options to buy the stockholders' remaining shares of capital stock of the Company. In 1983 Amexco transferred all of its shares in the Company and its rights under the Stock Purchase Agreement to American Express Travel Related Services Company, Inc. (TRS Co.), a wholly-owned subsidiary of Amexco. Reference herein to TRS Co. shall be deemed to mean TRS Co. or, prior to January 1983, Amexco as TRS Co.'s predecessor as holder of the capital stock of the Company. TRS Co. purchased the remaining 20% of the capital stock of the Company in 5% increments in 1981 and 1982 and 10% in 1983 prior to the public offering.

At December 31, 1983, TRS Co. owned 100% of the outstanding Class A Stock of the Company, which represented approximately 75% of the shares of capital stock of the Company then outstanding and approximately 96% of the voting power of the capital stock of the Company then outstanding.

The Company's financial statements are on the same basis as in the consolidated financial statements of TRS Co., in accordance with an accounting position taken by the Staff of the Securities and Exchange Commission that TRS Co.'s cost in excess of the fair value of the net assets acquired should be reflected in the Company's financial statements. Since the fair value of the Company's identifiable net assets approximated book value, the effect is to record the asset designated as "Intangible Assets—TRS Co." TRS Co. acquired the capital stock of the Company during the period

1980-1983. The balance sheet effect is to increase the Company's total assets and shareholders' equity by $63,530,000 and $51,067,000 at December 31, 1983 and 1982, respectively, representing the unamortized portion of such intangible asset. The income statement effect is to reduce net income by $1,537,000. $1,136,000 and $969,000 for the years ended December 31, 1983, 1982 and 1981, respectively, reflecting amortization of such intangible assets.

2. Significant Accounting Policies

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Depreciation and Amortization—Depreciation of property and equipment is computed on the straight-line method over the estimated useful lives of the assets. Expenditures that extend the remaining useful lives of property and equipment are capitalized and the cost of maintenance and repairs is charged to expense as incurred. Maintenance and repairs amounted to $3,127,000, $2,174,000 and $1,830,000 in the years ended December 31, 1983, 1982 and 1981, respectively.

Intangible assets consist of the excess of TRS Co.'s cost of the Company over the fair value of the acquired net assets at the date purchased, the excess of cost over net assets of businesses acquired by the Company and the value of credit card servicing contracts and the customer base acquired. The excess of cost over net assets is being amortized over 40 years. The value of credit card servicing contracts is being amortized over 39 months and the customer base over the following seven years.

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4. Intangible Assets

Intangible assets—TRS Co. and the related amortization thereof are stated separately on the consolidated balance sheet and consolidated statement of income respectively. Intangible assets relate to credit card service contracts and customer bases of $4,482,000 and $6,628,000 at December 31, 1983 and 1982, respectively, and the excess of cost over net assets of businesses acquired by the Company at date of acquisition of $10,772,000 at December 31, 1983 and $7,132,000 at December 31, 1982. Amortization of intangible assets excluding the TRS Co. amortization amounted to $1,864,000, $588,000 and $140,000 in the years ended December 31, 1983 and 1982 and 1981, respectively.

Consolidated Statement of Changes in Stockholders' Equity
Years ended December 31, 1983, 1982 and 1981
(Dollars in thousands)

	Total	Common Stock	Class A Stock	Class B Stock	Capital in Excess of Par Value	Retained Earnings
Balances at December 31, 1980	$ 57,843	$	$188	$	$ 51,519	$ 6,136
Intangible assets—TRS Co.	6,500				6,500	
Net income	12,810					12,810
Balances at December 31, 1981	77,153		188		58,019	18,946
Intangible assets—TRS Co.	8,000				8,000	
Net income	16,046					16,046
Balances at December 31, 1982	101,199		188		66,019	34,992
Intangible assets—TRS Co.	14,000				14,000	
Sale of Common Stock	52,400	40			52,360	
Sale of Class B Stock	4,010			21	3,989	
Contribution from TRS Co.	1,591				1,591	
Compensation related to issuance of Class B Stock	1,002				1,002	
Dividends paid	(58,000)				(13,491)	(44,509)
Net income	20,613					20,613
Balances at December 31,1983	$136,815	$40	$188	$21	$125,470	$11,096

See accompanying notes.

GENERAL PORTLAND INC.
Consolidated Statements of Income (Loss) and Retained Earnings (Deficit)
(in thousands)

Years Ended December 31,	1982	1981 (Restated)	1980
Consolidated Income (Loss)			
Net sales	$348,051	$334,055	$312,504
Costs and expenses:			
Cost of goods sold	323,428	290,700	258,391
Selling and administrative	30,268	22,559	20,236
Interest, net	7,798	3,393	(4,460)
Tender offer costs	—	9,210	—
Other (income) expense, net	(964)	(3,827)	(2,737)
Total costs and expenses	360,530	322,035	271,430
Income (loss) before taxes	(12,479)	12,020	41,074
Income taxes (benefit)	(4,200)	4,073	15,800
Net Income (Loss)	$ (8,279)	$ 7,947	$ 25,274
Consolidated Retained Earnings (Deficit)			
Retained earnings at beginning of year	$ 234	$139,755	$120,363
Net income (loss)	(8,279)	7,947	25,274
Cash dividends	(32,850)	(5,205)	(5,882)
Elimination of retained earnings at purchase date resulting from the acquisition of the company	—	(142,263)	—
Retained Earnings (Deficit) at End of Year	$(40,895)	$ 234	$139,755

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Acquisition of the Company by Canada Cement Lafarge Ltd.

General Portland was acquired by Canada Cement Lafarge in November 1981 for $47 per share or a total of $326.5 million. The company prepared the financial statements in its 1981 Annual Report on a historical cost basis consistent with prior years, but reflected itself as a wholly owned subsidiary of Canada Cement Lafarge. However, as 1982 progressed it became apparent that a preferable means of financial reporting for General Portland would be to reflect in the company's financial statements the effect of the purchase price adjustments that resulted from the recognition of fair values in connection with the company's acquisition by Canada Cement Lafarge.

Accordingly, General Portland's previously reported 1981 financial statements and information have been restated to reflect the fair value acquisition adjustments effective with the purchase of the company in November 1981. At December 31, 1981, the fair value adjustments added approximately $80 million to net property, plant and equipment, $4.6 million to inventory and $27.3 million to the excess of cost over net assets of businesses acquired. In addition, $32.5 million in deferred federal income tax credits and investment tax credits were eliminated in accordance with the requirements of generally accepted accounting principles.

Restatement of 1981 Financial Statements

The restatements described above reflect the substance of the reorganization of the company and its affiliates that was initiated in November 1981 when General Portland was acquired. The company believes that these restatements will make its financial statements more meaningful and will facilitate the company's accounting to reflect its combination with an affiliated operation and the acquisition price paid by Canada Cement Lafarge.

As a result of the adjustments previously discussed, the company's statement of income for the year ended December 31, 1981, has been restated. The following table reflects the significant adjustments to the net sales and net income amounts previously reported (in thousands):

Year Ended December 31, 1981	Net Sales	Net Income
Amounts as previously reported	$326,152	$ 9,081
Citadel operations for November and December 1981	7,903	(595)
Additional depreciation and amortization arising from recording the purchase price paid for the company	—	(355)
Other	—	(184)
Restated amounts	$334,055	$ 7,947

Accounting Policies

The company's accounting and reporting policies conform to generally accepted accounting principles and industry practices and are applied on a consistent basis between periods except for the change in accounting method for investment tax credits discussed above. The following is a summary of the company's significant accounting policies.

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Excess of Cost Over Net Assets of Businesses Acquired

The excess of the amount paid over the net assets obtained in the acquisition of the company by Canada Cement Lafarge is being amortized on the straight-line basis over a period of 40 years. The increase in this excess cost during 1982 results from adjustments to the original allocation of the purchase price paid by Canada Cement Lafarge. These adjustments primarily reflect a refinement in the values assigned to property, plant and equipment.

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Earnings Per Share

Due to the acquisition of the company by Canada Cement Lafarge, earnings per share are not meaningful or comparable to prior years' financial statements. As a result, no earnings per share amounts are included in this annual report.

Inventories

Inventories consist of the following (in thousands of dollars):

December 31,	1982	1981 (Restated)
Finished products	$ 22,997	$ 20,951
Work in process and raw materials	13,944	12,052
Fuel	2,420	2,917
Maintenance and operating supplies	17,512	19,332
Total inventories	$ 56,873	$ 55,252

Substantially all inventories other than maintenance and operating supplies are stated at LIFO cost. If the average cost method had been used, inventories would have been higher by $5.6 million at December 31,1982, and by $3.9 million at December 31, 1981. As required by Accounting Principles Board Opinion No. 16, inventories of General Portland were recorded at estimated fair value at the date of the company's acquisition. Accordingly, at December 31, 1982 and 1981, the financial accounting basis for the LIFO inventories exceeded the tax basis by approximately $4,639,000.

Property, Plant and Equipment

Property, plant and equipment consist of the following (in thousands of dollars):

December 31,	1982	1981 (Restated)
Land and mineral deposits	$ 46,167	$ 51,145
Buildings, machinery and equipment	355,022	350,376
Construction in progress	1,950	1,345
Property, plant and equipment, at cost	403,139	402,866
Less accumulated depreciation and depletion	46,900	21,101
Net property, plant and equipment	$356,239	$381,765

Other Assets

Other assets consist of the following (in thousands of dollars):

December 31,	1982	1981 (Restated)
Real estate investments	$ 4,744	$ 5,284
Long-term notes receivable	4,862	3,584
Miscellaneous	3,987	4,930
Total other assets	$ 13,593	$ 13,798

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Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consist of the following (in thousands of dollars):

December 31,	1982	1981 (Restated)
Trade accounts payable	$ 17,037	$ 16,642
Accrued payroll expense	5,480	7,482
Accrued insurance expense	3,832	3,313
Accrued acquisition costs	—	6,721
Other accrued expenses	12,619	8,305
Total accounts payable and accrued liabilities	$ 38,968	$ 42,463

Income Taxes

Income tax expense (benefit) includes the following components (in thousands of dollars):

Years Ended December 31,	1982	1981 (Restated)	1980
Federal income taxes (benefit):			
Current	$ (5,795)	$ (2,035)	$ 3,794
Deferred	1,495	5,019	4,005
Net deferred investment tax credits	—	539	6,451
State income taxes	100	550	1,550
Total income taxes (benefit)	$ (4,200)	$ 4,073	$ 15,800

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Deferred Credits

Deferred credits consist of the following (in thousands of dollars):

December 31,	1982	1981 (Restated)
Federal income taxes	$ 1,937	$ 1,567
Investment tax credits	—	66
Other—primarily pension costs	4,946	4,940
Total deferred credits	$ 6,883	$ 6,573

Debt

Long-term debt is summarized as follows (in thousands of dollars):

December 31,	1982	1981 (Restated)
Unsecured notes payable to insurance companies—		
9.125% notes due in annual installments of $2,000	$26,000	$28,000
9.375% notes due in annual installments of $1,875	24,375	26,250
5.9-9.875% industrial revenue bonds secured by certain pollution control facilities maturing in various amounts in years 1998 to 2010 with annual sinking fund requirements beginning in 1989	17,725	17,725
7.8% sinking fund debentures	13,200	13,200
10% unsecured notes, payable $1,963 annually	1,963	3,925
Other	769	2,276
	84,032	91,376
Less current portion	(6,064)	(6,084)
Total long-term debt	$77,968	$85,292

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Shareholders' Equity

The company became a wholly owned subsidiary of Canada Cement Lafarge at the end of 1981. As a result of this acquisition, all of the company's previously outstanding common stock was cancelled, and the company issued 1,000 new shares of $1 par value common stock. The company's financial statements reflect this acquisition and the resulting fair value adjustments along with the acquisition of the Citadel net assets, effective as of November 1981.

Changes affecting common stock and capital in excess of par value for 1982, 1981 and 1980 are as follows (in thousands):

	Common Stock		Capital in Excess of
	Shares	Par Value	Par Value
Balance at December 31, 1979	6,892	$ 6,892	$ 34,154
Stock options exercised	36	36	385
Balance at December 31, 1980	6,928	6,928	34,539
Stock options exercised	19	19	339
Stock cancelled due to acquisition	(6,947)	(6,947)	6,947
Stock issued due to acquisition	1	1	—
Fair value adjustments related to acquisition	—	—	145,095
Elimination of pre-acquisition retained earnings	—	—	142,263
Citadel net asset acquisition	—	—	72,708
Balance at December 31, 1981	1	1	401,891
Additional capital contribution	—	—	14,722
Balance at December 31, 1982	1	$ 1	$416,613

Through November 1982, the company had authorized 1,000 shares of $1 par value common stock. At that time, the number of authorized shares was changed to 5,000 shares of $1 par value common stock by an amendment to the company's Certificate of Incorporation. In connection with the Citadel net asset acquisition, the company issued an additional 250 shares of its $1 par value common stock.

Auditors' Report

To the Shareholders and Directors
General Portland Inc.

We have examined the consolidated balance sheets of General Portland Inc. (a Delaware corporation and wholly owned subsidiary of Canada Cement Lafarge Ltd.) and subsidiaries as of December 31, 1982 and 1981, and the related consolidated statements of income (loss) and retained earnings (deficit) and changes in financial position for each of the three years in the period ended December 31, 1982. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the December 31, 1981 statement of operating assets and liabilities of Citadel Cement Corporation (Citadel), which reflects total assets constituting 20% of the related consolidated assets. This statement was examined by other auditors whose report thereon has been furnished to us. Our opinion expressed herein, insofar as it relates to the amounts included for Citadel as of December 31, 1981, is based solely upon the report of the other auditors.

As more fully explained in the Notes to Consolidated Financial Statements, the financial statements of General Portland Inc. and subsidiaries for the year ended December 31, 1981, have been restated to reflect, as of the date the company was acquired by Canada Cement Lafarge Ltd. (November 1981): (1) the purchase price adjustments related to that acquisition and (2) the acquisition by the company of the assets and liabilities of Citadel, which also is a wholly owned subsidiary of Canada Cement Lafarge Ltd. In addition, in 1982 the company changed its method of accounting for investment tax credits from the deferral to the flow through method in order to be consistent with the accounting method used by its parent, Canada Cement Lafarge Ltd.

In our opinion, based upon our examination and the report of other auditors referred to above, the consolidated financial statements referred to above present fairly the financial position of General Portland Inc. and subsidiaries as of December 31, 1982 and 1981, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1982, in conformity with generally accepted accounting principles, which, after giving effect to the change in the basis of reporting in 1981 referred to in the preceding paragraph (with which we concur) and except for the change (with which we concur) in the method of accounting for investment tax credits in 1982, have been applied on a consistent basis.

Dallas, Texas
January 28, 1983

MAXICARE HEALTH PLANS, INC.
Notes to Consolidated Financial Statements

Note 1—Significant Accounting Policies

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INTANGIBLES: Goodwill and organization costs are amortized using the straight-line method over forty and five years, respectively. In accordance with Staff Accounting Bulletin #54 of the Securities and Exchange Commission, the cost of Fremont's investment in the Company is reflected in the financial statements of the Company ("pushdown accounting"). The financial statements of the Company reflect the allocation of the consideration paid for the common stock in excess of the net assets acquired on the same basis as in consolidation with Fremont. Unamortized balances are as follows:

(Amounts in thousands)	December 31, 1983	December 31, 1982
Goodwill	$11,958	$12,874
Organization costs	225	111
	$12,183	$12,985

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Note 2—Acquisition by Fremont

Fremont purchased 54% and 40% of the Company's common stock in January and September 1982, respectively. These transactions were accounted for using the purchase method. The remaining shares were owned by the Company's management. The consideration paid for the Company was approximately $14,590,000, which exceeded the net assets acquired by approximately $10,232,000. Accordingly, in order to reflect the excess of consideration paid over net assets acquired, intangible assets and shareholders' equity were increased by $10,232,000.

The financial statements for the years ended December 31, 1983 and 1982 are not comparable to the prior financial statements of the Company ("predecessor operations prior to Fremont's acquisition").

On September 22, 1983, Fremont sold 550,000 shares of the Company's common stock in connection with the issuance of 55,000 units of senior subordinated debentures. As a result, Fremont's ownership of the Company was reduced to 84%.

Consolidated Statements of Changes in Shareholders' Equity

(Amounts in thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Total
Balance at January 1, 1982	$ 202	$ 37	$1,312	$ 1,551
Issuance of common stock	2,500			2,500
Consideration paid by Fremont General Corporation in excess of the net assets acquired and reclassification of retained earnings resulting from "pushdown accounting"		11,544	(1,312)	10,232
Net income			2,507	2,507
Balance at December 31, 1982	2,702	11,581	2,507	16,790
Issuance of common stock	15,879			15,879
Net income			5,386	5,386
Balance at December 31, 1983	$18,581	$11,581	$7,893	$38,055

See notes to consolidated financial statements.

PRINCEVILLE DEVELOPMENT CORPORATION
Consolidated Balance Sheet at November 30, 1984
AND PRINCEVILLE DEVELOPMENT CORPORATION
(a wholly owned subsidiary of Consolidated Oil & Gas, Inc.)
Consolidated Balance Sheet at November 15, 1984,
with Supplementary Subsidiary Information

		As a Subsidiary of Consolidated Oil & Gas, Inc. (Note 1)		
			Supplementary Subsidiary Information	
Assets	November 30, 1984	November 15, 1984 After the Pushdown Adjustment	Pushdown Adjustment	November 15, 1984 Before Pushdown Adjustment
Cash and cash equivalents (Note 5)	$10,506	$10,408		$10,408
Notes and contracts receivable, net (Note 3)	1,862	1,701		1,701
Accrued interest and other receivables	544	646		646
Developed and undeveloped real estate (Note 4)	6,525	6,550	$(18,228)	24,779
Property and equipment, net (Note 6)	6,551	6,550	(6,873)	13,424
Inventory	194	199	(271)	470
Other assets	647	661		661
Investment in real estate partnership (Note 5)	10,399	10,393		10,393
	$37,232	$37,111	$(25,373)	$62,484

Liabilities and Stockholders' Equity				
Note payable (Note 8)	$ 2,000	$ 2,000		$ 2,000
Accounts payable	339	371		371
Accrued expenses	371	355		355
Aircraft overhaul reserve	201	195		195
Deposits	81	65		65
Other liabilities	84	81		81
Payable to parent	—	28		28
Total liabilities	3,078	3,097		3,097
Deferred income	348	354		354
Stockholders' equity (Notes 1, 10 and 13):				
Common stock, 25,000,000 shares of $0.20 par value authorized: 8,740,000 shares issued and outstanding of the Company at November 30, 1984 and of the Subsidiary at November 15, 1984	1,748	1,748		1,748
Capital surplus at November 15, 1984		53,702		53,702
Retained earnings (deficit) at November 15, 1984		(21,791)	$(25,373)	3,582(a)
Capital surplus at November 30, 1984	31,911	31,911		
Retained earnings at November 30, 1984	146			
Total stockholders' equity	33,805	33,659	(25,373)	59,033
	$37,232	$37,111	$(25,373)	$62,485

(a) After quasi-reorganization on December 1, 1983

The accompanying notes are an integral part of these consolidated financial statements.

Notes to Consolidated Financial Statements

1. Formation of the Company and Basis of Presentation:

Princeville Development Corporation, or the "Company", was incorporated as a Colorado corporation on November 7, 1979, primarily for the purpose of acquisition, development, sale and operation of real estate and resort properties and related activities. Prior to November 16, 1984, the Company was a wholly owned subsidiary of Consolidated Oil & Gas, Inc. ("Consolidated") and is referred to in these financial statements as the subsidiary for that prior period. Initial operations commenced on January 1, 1980, upon the issuance of 2,551,200 shares of the subsidiary's common stock to Consolidated in exchange for certain realty assets (primarily real estate, property and equipment and related depreciation) and the assumption of related liabilities of Consolidated's real estate division and all of the outstanding shares of common stock of certain wholly owned subsidiaries of Consolidated. Through November 15, 1984, an aggregate of 8,740,000 shares of the subsidiary's common stock were issued to Consolidated in exchange for realty and resort assets. The exchanges referred to above were initially recorded on the subsidiary's books at Consolidated's historical costs at the dates of transfer and were subsequently adjusted at November 15, 1984, to reflect the fair value of the subsidiary which was established in the rights offering as discussed below.

Effective November 15, 1984, Consolidated completed the sale of all the subsidiary's common stock through a rights offering to Consolidated's shareholders and third party purchasers of the rights. Under the terms of the offering, each right entitled its holder to purchase one share of the subsidiary's common stock from Consolidated for $3.25. Immediately prior to the sale of the subsidiary, Consolidated adjusted its investment in the subsidiary to reflect its fair value as determined by the rights offering, by aggregating the market value of the rights and the consideration to be received. Consolidated's new basis in its investment in the subsidiary was then "pushed down" to the separate financial statements of the subsidiary. When the rights were exercised, the historical cost basis of the subsidiary's net assets had been adjusted, similar to purchase accounting, to reflect the cost basis to the new owners of Princeville Development Corporation. Accordingly, the historical cost basis of the subsidiary's net assets of $59,033,324 immediately prior to the sale was adjusted downward to $33,659,408 to reflect the market value of the rights ($5,254,408) and the consideration ($28,405,000) which was received by Consolidated. Such adjustment was allocated to the assets and liabilities acquired based upon the relative values thereof as estimated by management. A summary of this writedown of the subsidiary's assets by balance sheet classification is as follows:

Developed and undeveloped real estate	$18,228,965
Property and equipment, net	6,873,775
Inventory	271,176
	$25,373,916

The financial position of the subsidiary at November 15, 1984, which for financial reporting purposes is deemed to be a predecessor entity, and certain related footnote disclosures have been provided herein as additional information.

4. Developed and Undeveloped Real Estate:

The developed and undeveloped real estate is carried at cost. The real estate of the Company at November 30, 1984 and of the subsidiary at November 15, 1984 is classified as follows:

		The Subsidiary (See Note 1)		
			Supplementary Subsidiary Information	
	November 30, 1984	November 15, 1984 after Pushdown Adjustment	Pushdown Adjustment	November 15, 1984 before Pushdown Adjustment
Princeville land held for resale	$1,338,870	$1,341,242	$ 3,252,608	$ 4,593,850
Colorado land held for resale	1,000	1,000	72,602	73,602
Hotel land	2,710,124	2,710,124	—	2,710,124
Princeville unimproved land held for future development	1,307,196	1,330,073	11,891,921	13,221,994
Condominiums held for resale	1,167,286	1,166,929	2,737,834	3,904,763
Land held for investment	1,000	1,000	274,000	275,000
	$6,525,476	$6,550,368	$18,228,965	$24,779,333

6. Property and Equipment:

The property and equipment of the Company at November 30, 1984 and of the subsidiary at November 15, 1984, is classified as follows:

		The Subsidiary (See Note 1)		
			Supplementary Subsidiary Information	
	November 30, 1984	November 15, 1984 after Pushdown Adjustment	Pushdown Adjustment	November 15, 1984 before Pushdown Adjustment
Shopping center, including land	$1,792,520	$1,791,308	$4,887,833	$ 6,679,141
Land, buildings and improvements	703,244	701,722	2,502,812	3,204,534
Furniture and equipment	516,305	516,305	1,304,161	1,820,466
Water supply system	1,176,924	1,176,924	—	1,176,924
Recreational facilities	2,251,355	2,246,768	978,243	3,225,011
Aircraft	1,942,380	1,942,380	—	1,942,380
	8,382,728	8,375,407	9,673,049	18,048,456
Less accumulated depreciation	1,830,768	1,825,038	2,799,274	4,624,312
	$6,551,960	$6,550,369	$6,873,775	$13,424,144

Depreciation expense of the Company for the period November 16, 1984 through November 30, 1984 was $5,730.

10. Capital Stock

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Princeville Development Corporation (a wholly owned subsidiary of Consolidated Oil & Gas, Inc.) at November 15, 1984:

Effective December 1, 1983, the shareholder of the subsidiary approved a quasi-reorganization. This resulted in a reclassification of the accumulated deficit of $11,937,666 at November 30, 1983, to capital surplus. In the opinion of management, there was no indication of impairment of its assets at that date which would have required their writedown in conjunction with the quasi-reorganization.

14. Selected Operating Data of the Subsidiary:

	For the Period December 1, 1983 through November 15, 1984
Revenues:	
Resort operations	$ 3,170,417
Sales of real estate	7,868,228
Rental income	771,294
Interest and other income	891,735
	12,701,674
Costs and expenses:	
Resort operating costs	3,644,613
Operating and selling expenses	2,245,951
Cost of sales	2,990,860
Excise taxes	237,863
Interest expense	—
Other	—
	9,119,287
Income (Loss) from continuing operations before pushdown adjustment	3,582,387
Pushdown adjustment (Note 1)	(25,373,916)
(Loss) from continuing operations	$(21,791,529)

VEREX CORPORATION
Significant Accounting and Financial Policies

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Basis of Presentation:

The Greyhound Corporation ("Greyhound") owns all of the outstanding common stock of Verex.

The consolidated financial statements for 1978 include the accounts of Verex and its subsidiaries on the same basis as they are included in Greyhound's consolidated financial statements, which gives effect to allocating the cost of Greyhound's investment in Verex ("Greyhound cost basis") as though it was acquired on January 1, 1978. The consolidated financial statements for 1977 are presented on the historical basis of accounting of Verex and include the accounts of Verex and its subsidiaries. For comparative purposes, a pro forma consolidated income statement for the year ended December 31, 1977 has also been presented reflecting the acquisition by Greyhound as if it occurred on January 1, 1977.

All material intercompany transactions and accounts are eliminated in consolidation. Certain balances in the accompanying financial statements for 1977 have been reclassified to make the presentation consistent with the classifications used for 1978.

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Intangible:

The intangible arising from the acquisition of Verex by Greyhound is being amortized on the straight-line method over 40 years.

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Notes to Consolidated Financial Statements

Years Ended December 31, 1978 and 1977
(000 omitted in tables)

Note A—Greyhound's Investment in Verex:

Through March of 1978 Greyhound had acquired approximately 95 per cent of the common stock of Verex as a result of a tender offer. An accrual for the purchase of the remaining outstanding shares of Verex was established as of March 31, 1978 by Greyhound. The remaining 5 per cent interest was acquired through subsequent purchases and the merger of Verex into a wholly-owned subsidiary of Greyhound. The aggregate cost of the investment in Verex by Greyhound was approximately $109,372,000.

The principal adjustments to the historical financial statements of Verex to reflect the Greyhound cost basis were:

1. The carrying values of bonds and notes and land, office building and equipment were adjusted to estimated fair market value.

2. Since Verex has discontinued its mobile home loan insurance and real estate financing businesses and suspended writing of new business in the commercial mortgage and lease guaranty insurance business, the net assets of these businesses, after giving consideration to estimated future costs and losses, were recorded at their estimated net realizable value.

3. Outstanding convertible subordinated debentures were discounted to present value utilizing a current borrowing rate.

4. In connection with the tender offer, Verex incurred compensation expenses and legal and advisory fees, including amounts paid to a firm with which a former director of Verex is affiliated. The compensation relates principally to agreements for the repurchase of stock options. The agreements generally provide for payment of the excess of $30 per share over the option price, and in some cases deferral of payment conditioned on the optionees' continuous employment. As a result of these agreements, there are no Verex stock options outstanding at December 31, 1978. These costs, which were reported as extraordinary items in the historical financial statements, have been charged to retained income as of January 1, 1978 as a valuation adjustment:

Legal and investment advisor's fees	$1,284
Employee compensation, including estimated future payments	4,134
	5,418
Less income tax benefit	1,984
	$3,434

5. Debentures in the principal amount of $12,699,000 converted to common stock in 1978 and $3,350,000 of debentures acquired by Greyhound and contributed to Verex have been treated as though such transactions occurred prior to Greyhound's acquisition.

6. The excess of Greyhound's carrying cost of its investment in Verex over the related fair value of net assets of Verex at date of acquisition has been credited to additional capital.

Consolidated Income Statement (000 omitted)

	Year Ended December 31,		
	1978	1977	1977
	Pro forma		Historical
Revenues:			
Underwriting income:			
Net premiums written	$34,991	$28,616	$29,174
Increase in unearned premiums	(4,788)	(4,771)	(4,587)
Premiums Earned	30,203	23,845	24,587
Investment Income, net of advisor's fees and administrative expenses of $411, $391, and $447	8,205	6,699	7,422
	38,408	30,544	32,009
Expenses:			
Losses	4,927	4,488	4,531
Loss adjustment	612	512	694
	5,539	5,000	5,225
Insurance acquisition costs, net of change in deferred insurance acquisition costs	11,500	10,381	10,668
Interest (Notes D, E and F)	1,761	1,917	2,075
Other, net	2,137	2,063	1,120
	20,937	19,361	19,088
Income Before Income Taxes	17,471	11,183	12,921
Income Taxes (Note G)	7,802	4,818	5,274
Income Before Net Realized Investment Gains (Losses) and Extraordinary Item	9,669	6,365	7,647
Net Realized Investment Gains (Losses), net of income tax effects (excluding net unrealized losses on stocks of $1,322, $599 and $599)	(82)	13	71
Income Before Extraordinary Item	9,587	6,378	7,718
Extraordinary Item—reduction of income taxes arising from realization of benefit of prior years' accounting and investment losses			5,274
Net Income	$ 9,587	$ 6,378	$12,992

See notes to consolidated financial statements and summary of significant accounting and financial policies.

Statement of Stockholder's Equity (000 omitted)

	Common Stock	Additional Capital	Unrealized Investment Gains (Losses)	Retained Income
Balance, January 1, 1977	$ 5,703	$40,015	$ 523	$ (250)
Issuance of shares:				
Stock split (Note H)	2,854	(2,854)		
Stock options exercised	39	67		
Net income—historical				12,992
Unrealized gains (losses) on stocks—net change			(599)	
Dividends paid				(421)
Balance, December 31, 1977	8,596	37,228	(76)	12,321
Pro forma adjustments (Note A):				
Adjustment to recognize the excess of cost over fair value of assets acquired by Greyhound		38,545		
Conversions of convertible subordinated debentures	639	13,656		
Merger and recapitalization of Verex, including cancellation of treasury stock of $900	765	8,645	76	(12,321)
Pro forma balance, January 1, 1978	10,000	98,074		
Pro forma net income				9,587
Pro forma amounts prior to acquisition by Greyhound		1,298	478	(1,776)
Unrealized gains (losses) on stocks—net change			(1,322)	
Balance, December 31, 1978	$10,000	$99,372	$ (844)	$ 7,811

See notes to consolidated financial statements and summary of significant accounting and financial policies.

Report of Independent Accountants

To The Board of Directors
of Verex Corporation

We have examined the statement of consolidated financial condition of Verex Corporation (a subsidiary of The Greyhound Corporation) and subsidiaries as of December 31, 1978, and the related statements of income, stockholder's equity and changes in financial position for the year then ended. The foregoing financial statements reflect the adjustments arising from the acquisition of Verex Corporation by The Greyhound Corporation described in Note A of Notes to Consolidated Financial Statements. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The consolidated financial statements for the year ended December 31, 1977, presented on the historical basis of accounting of Verex Corporation, were examined by other certified public accountants whose report thereon was furnished to us.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Verex Corporation and subsidiaries at December 31, 1978, and the results of their operations and the changes in their financial position for the year then ended, in conformity with generally accepted accounting principles.

In addition, we have reviewed the effect given, in the pro forma consolidation income statement of Verex Corporation for the year ended December 31, 1977, to the adjustments described in Note A of Notes to Consolidated Financial Statements. In our opinion, such pro forma statement has been properly compiled on the basis described.

Milwaukee, Wisconsin
February 23, 1979

TRI-AMERICAN CORPORATION AND SUBSIDIARIES

Consolidated Statements of Shareholders' Equity

Year ended December 31, 1981, 1980 and 1979

	Common shares	Additional paid-in capital	Retained earnings	Unrealized losses on investments in equity securities
			(In thousands)	
Balance at January 1, 1979	$ 100	$ 2,627	$ 2,850	$(185)
Net earnings			1,085	
Preferred dividends ($.75 a share)			(10)	
Common dividends ($.04 a share)			(40)	
Issuance of 50 Common Shares for exercise of stock option				
Unrealized depreciation on investments in equity securities—net				(140)
Balance at December 31, 1979	100	2,627	3,885	(325)
Net earnings			940	
Preferred dividends ($.75 a share)			(10)	
Common dividends ($.05 a share)			(50)	
Issuance of Common Shares purchased under stock purchase plan and exercise of stock option	1	24		
Unrealized depreciation on investments in equity securities—net				(136)
Balance at December 31, 1980	101	2,651	4,765	(461)
Net earnings—six months ended June 30, 1981			148	
Common dividends ($.05 a share)			(51)	
Issuance of Common Shares purchased under stock purchase plan, exercise of stock option and conversion of outstanding warrants	15	1,277		
Unrealized appreciation on investments in equity securities—six months ended June 30, 1981				10
Redemption of Preferred Shares		130		
Balance at June 30, 1981	116	4,058	4,862	(451)
Merger transactions (note B)				
Retirement of Common Shares and related equity accounts pursuant to the merger with SYII, Inc.	(116)	(4,058)	(4,862)	451
Cost to SYII, Inc. to acquire Tri-American Corporation—SYII, Inc.'s contribution to capital		13,842		
Issuance of 1,200,000 Common shares pursuant to the merger	120	(120)		
Net loss—six months ended December 31, 1981			(261)	
Unrealized depreciation on investments in equity securities—six months ended June 30, 1981				(40)
Balance at December 31, 1981	$ 120	$13,722	$ (261)	$ (40)

The accompanying notes are an integral part of these statements.

Notes to Consolidated Financial Statements

Note A—Summary of Accounting Policies

A summary of significant accounting policies consistently applied in the preparation of the accompanying financial statements follows.

Principles of Consolidation

As a result of the merger approved by its shareholders, on July 13, 1981, the Company has become a wholly-owned subsidiary of Scottish & York International Insurance, Inc., of Princeton, New Jersey (S&YII, Inc.). The Company accounted for the merger using the "push-down" approach whereby its consolidated balance sheet at December 31, 1981, and the portion of its operating results of 1981 subsequent to the merger are reported on the same basis as included in S&YII, Inc.'s 1981 consolidated financial statements. See note B for a more complete description of the merger transaction and the application of "push-down" accounting.

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Note B—Merger

On July 13, 1981, the Company's shareholders approved the merger of the Company with SYII, Inc. (SYII), an indirect subsidiary of Scottish & York International Insurance, Inc. (S&YII). SYII had previously acquired, for $11.50 per share, approximately 62.5% of the Company's Common Shares under a tender offer. The merger agreement, which provided that Tri-American Corporation be the surviving Company, called for the purchase by SYII of all of the Company's Common Shares and all securities having a present or future claim to Common Share ownership. Common Shareholders received $11.50 per share. Holders of warrants and unexercised options to purchase Common Shares received cash equal to the amount by which $11.50 exceeded the warrant or option price multiplied by the number of Common Shares subject to each warrant or option.

Under the "push-down" accounting approach, the excess purchase price over the carrying value of the Company's net assets at June 30, 1981 was allocated as follows:

Item	Dollar Amount	Amortization Period
	(In Thousands)	
Goodwill	$4,973	40 years
Reduction in fixed maturity bond portfolio to market value at June 30, 1981	1,050	Bond maturity or disposal date
Reduction in 10¾% Sinking Fund Debentures Due 1994 to reflect current interest rates at June 30, 1981	900	Debenture Sinking Fund period
Favorable lease of home office building which term expires in 1989	485	Remaining term of lease
Increase in outstanding losses and claims at June 30, 1981, net of income taxes	125	1982

For purposes of financial reporting, the Company has accounted for the merger as if it took place on July 1, 1981.

The following summary compares the Company's 1981 operating results as reported to a pro forma of those results prepared on the assumption that the merger had not taken place.

	As Reported	Pro Forma
	(In Thousands)	
Revenues	$24,442	$24,309
Operating expenses	24,677	24,504
Loss before income taxes and net realized investment losses	235	195
Income taxes (credits)	(199)	(199)
Income (loss) before net realized investment results	(36)	4
Net realized investment losses	78	777
Net loss	$ 114	$ 773

The Company incurred $243,000 in professional fees in connection with the merger.

Auditors' Report

Board of Directors
Tri-American Corporation

We have examined the consolidated balance sheets of Tri-American Corporation and Subsidiaries as of December 31, 1981 and 1980, and the related consolidated statements of operations, shareholders' equity and changes in financial position for each of the three years in the period ended December 31, 1981. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in notes A and B to the financial statements, the Company has become, as a result of a merger in 1981, a wholly-owned subsidiary of Scottish & York International Insurance, Inc. of Princeton, New Jersey (S & YII, Inc.). The Company accounted for the merger using the "push-down" approach whereby its consolidated balance sheet at December 31, 1981, and the portion of its operating results of 1981 subsequent to the merger are reported on the same basis as included in S & YII, Inc.'s 1981 consolidated financial statements.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Tri-American Corporation and Subsidiaries at December 31, 1981 and 1980 and the consolidated results of their operations and changes in their financial position for each of the three years in the period ended December 31, 1981, in conformity with generally accepted accounting principles applied on a consistent basis.

Our examinations also comprehended the schedules listed in the Index at Items 11(a)2. In our opinion, such schedules, when considered in relation to the basic financial statements, present fairly in all material respects the information shown therein.

Certified Public Accountants

Cleveland, Ohio
February 18, 1982

Companies That Considered and Rejected Push Down Accounting

HARRIS BANKCORP, INC.
Notes to Financial Statements

19. Bank of Montreal Merger

On September 4, 1984, Harris Bankcorp, Inc. became a wholly-owned subsidiary of Bankmont Financial Corp. (formerly First Canadian Financial U.S. Holdings, Inc.), a Delaware corporation (name changed to Bankmont Financial Corp. as of November 29, 1984). Bankmont Financial Corp. is a wholly-owned subsidiary of Bank of Montreal. The purchase accounting adjustments associated with the acquisition are reflected on the books of Bankmont Financial Corp. and have not been "pushed down" to Harris Bankcorp. Transactions in the capital accounts of Harris Bankcorp which were related to the acquisition did not have a material impact on total stockholder's equity.

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STRUTHERS OIL & GAS CORP.
(A Majority-Owned Subsidiary of Southland Energy Corp.)
Notes to Consolidated Financial Statements

A. Change in Ownership and Going Concern

Effective November 30, 1982, Southland Energy Corp. ("Southland") and Struthers Wells Corporation ("Wells") entered into an agreement whereby Southland purchased from Wells its entire 82.2% interest in the common stock of the Company and $6,000,000 of intercompany receivables from the Company. In connection therewith, Wells made a contribution of $1,811,261 to the additional paid-in capital of the Company, representing the intercompany account balance in excess of $6,000,000, and assumed $948,529 of the Company's liabilities at November 30, 1982.

As a result of the Company's acquisition by Southland, the Company changed its fiscal year-end from November 30th to October 31st to coincide with Southland's year-end. The Company's results of operations and changes in financial position for the eleven months ended October 31, 1983 are not significantly different from those for the year ended November 30, 1983.

The Company's financial statements do not reflect Southland's cost of the acquisition in accordance with the requirements of "push down acquisition accounting". Such accounting would result in the Company's recognition of an excess of purchase price over net assets acquired as a result of Southland's acquisition of $6,000,000 of intercompany debt. Management does not believe it is appropriate to recognize this excess in the Company's financial statements in light of the significant minority interest and the financial condition of the Company.

As indicated in these financial statements, the Company has incurred losses of $5,945,903 from operations subsequent to its acquisition, is in default on approximately $6,314,412 of its indebtedness to a bank (Note D) and has guaranteed a substantial amount of its partnerships' bank debt, which is also in default (Note G). At October 31, 1983, the Company has a deficiency in working capital of $6,732,835 and a deficiency in net assets of $6,543,253. On October 27, 1983, as a result of the Company's financial condition, Southland's Board of Directors directed Southland's management to arrange for the disposition of Struthers. Accordingly, as Southland has neither assumed nor guaranteed any of the Company's liabilities, its control of the Company is considered temporary. Southland has made no permanent advances to the Company since its acquisition and has also indicated that it intends to make no future advances to the Company. Subsequent to year-end, however, Southland has been actively negotiating with the Company's bank in an effort to restructure the Company's debt and thereby make it a more attractive acquisition candidate.

APPENDIX A

STAFF ACCOUNTING BULLETIN NO. 54

RELEASE No. 54, November 3, 1983, 48 F.R. 51769.

Application of "Push Down" Basis of Accounting in Financial Statements of Subsidiaries Acquired by Purchase

AGENCY: Securities and Exchange Commission.

ACTION: Publication of Staff Accounting Bulletin.

SUMMARY: This staff accounting bulletin expresses the staff's views regarding the application of the "push down" basis of accounting in the separate financial statements of subsidiaries acquired in purchase transactions.

DATE: November 3, 1983

FOR FURTHER INFORMATION CONTACT: Michael P. McLaughlin, Office of the Chief Accountant (202/272-2130); or Howard P. Hodges, Jr., Division of Corporation Finance (202/272-2553), Securities and Exchange Commission, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION: The statements in Staff Accounting Bulletins are not rules or interpretations of the Commission nor are they published as bearing the Commission's official approval. They represent interpretations and practices followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the Federal securities laws.

Part 211—[Amended]

Accordingly, Part 211 of Title 17 of the Code of Federal Regulations is amended by adding Staff Accounting Bulletin No. 54 to the table found in Subpart B.

STAFF ACCOUNTING BULLETIN NO. 54

The staff herein adds Section J to Topic 5 of the Staff Accounting Bulletin Series. This section discusses the staff's position on the appropriateness of applying the "push down" basis of accounting in the separate financial statements of subsidiaries acquired in purchase transactions.

J. Push Down Basis of Accounting Required in Certain Limited Circumstances.

Facts: Company A (or Company A and related persons) acquired substantially all of the common stock of Company B in one or a series of purchase transactions.

Question 1: Must Company B's financial statements presented in either its own or Company A's subsequent filings with the Commission reflect the new basis of accounting arising from Company A's acquisition of Company B when Company B's separate corporate entity is retained?

Interpretive Response: Yes. The staff believes that purchase transactions that result in an entity becoming substantially wholly owned (as defined in Rule 1-02 (z) of Regulation S-X) establish a new basis of accounting for the purchased assets and liabilities.

When the form of ownership is within the control of the parent the basis of accounting for purchased assets and liabilities should be the same regardless of whether the entity continues to exist or is merged into the parent's operations. Therefore, Company A's cost of acquiring Company B should be "pushed down," i.e., used to establish a new accounting basis in Company B's separate financial statements.[1]

Question 2: What is the staff's position if Company A acquired less than substantially all of the common stock of Company B or Company B had publicly held debt or preferred stock at the time Company B became wholly owned?

Interpretative Response: The staff recognizes that the existence of outstanding public debt, preferred stock or a significant minority interest in a subsidiary might impact the parent's ability to control the form of ownership. Although encouraging its use, the staff generally does not insist on the application of push down accounting in these circumstances.

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[1]The Task Force on Consolidation Problems, Accounting Standards Division of the American Institute of Certified Public Accountants issued a paper entitled "Push Down" Accounting, October 30, 1979. This paper addresses the issues relating to "push down" accounting, cites authoritative literature and indicates that a substantial change in ownership justifies a new basis of accounting. The AICPA submitted the paper to the FASB with a recommendation that the Board consider the issue. The FASB has included push down accounting as an issue to be addressed in its major project on consolidation accounting.

[Added by SAB No. 54.]

APPENDIX B

ISSUES PAPER **OCTOBER 30, 1979**

"Push Down" Accounting

Prepared by
Task Force on Consolidation Problems
Accounting Standards Division
American Institute of Certified Public Accountants

INTRODUCTION

1. This paper addresses issues relating to the "push down" basis of accounting, which for the purposes of this paper is the establishment of a new accounting and reporting basis for an entity in its separate financial statements, based on a purchase transaction in the voting stock of the entity that results in a substantial change in the ownership of the outstanding voting stock of the entity. A primary question to be considered in push down accounting is whether there are circumstances in which the cost to the acquiring entity in a business combination accounted for by the purchase method[1] should be imputed to the acquired entity. Also, inconsistency has developed in practice in the accounting treatment followed when ownership of a subsidiary or other component of a business entity is transferred to new owners or when the ownership of an entire business entity is substantially changed.

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[1] The push down principle can be applied to all business combinations in which there has been an acquisition. Paragraph 12 of APB Opinion 16, "Business Combinations," states, however, that:

> The pooling of interests method accounts for a business combination as the uniting of the ownership interests of two or more companies by exchange of equity securities. No acquisition is recognized because the combination is accomplished without disbursing resources of the constituents. Ownership interests continue and the former bases of accounting are retained. The recorded assets and liabilities of the constituents are carried forward to the combined corporation at their recorded amounts.

Accordingly, push down accounting is inapplicable in business combinations accounted for by the pooling of interests method.

2. Proponents of push down accounting believe that transactions in an entity's voting stock that result in a substantial change in the ownership of the entity should result in a new basis of accounting (push down accounting) for the entity's assets, liabilities, and equity based on values established in the transactions. They believe that the accounting basis of the stock to the new owners should be "pushed down" to the entity and used to establish a new accounting basis in its financial statements. In push down accounting, the carrying amount of the stock to the entity's new ownership control group is deemed to be the cost of the net assets of the entity under "new entity" or "new basis" accounting.[2]

3. This paper explores whether and to what extent there are circumstances in which push down accounting should be required, permitted, or prohibited after changes of ownership of the following types:

a. Acquisition of an entity in a business combination accounted for by the purchase method. Should the new accounting basis recorded in the financial statements of the acquiring entity also be recognized in any separate financial statements of the acquired entity?

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[2] The term "new entity" or "new basis" accounting is used to describe the circumstances in which an existing entity is deemed to have established a new basis to record its assets and liabilities.

b. Acquisition by new owners of all or a substantial portion of the voting stock of an existing company or the sale in a secondary public offering[3] of all or a substantial portion of the voting stock of a company that was previously privately owned or was a subsidiary of a public company. Should the basis of the stock in the secondary offering be reflected in the financial statements of the entity?

c. Spinoffs or splitoffs by the distribution of shares of a subsidiary to the stockholders of a parent company. Should the transactions create a new basis of accounting in the financial statements of the company whose shares were distributed? How should that basis be determined?

4. As previously stated, push down accounting is the establishment of a new accounting and reporting basis for an entity in its separate financial statements based on a substantial change in the ownership of the outstanding stock of the entity. Push down accounting, however, is not a current value, consolidation, or business combination issue. Accordingly,

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3 A secondary public offering of stock is a registered, public offering usually through underwriters of a block of the outstanding stock of an entity by a single controlling stockholder or a group of controlling stockholders.

the division urges the Financial Accounting Standards Board to consider the issues raised in this paper separately from its projects in those areas.

RELEVANT ACCOUNTING LITERATURE

5. The authoritative accounting literature contains no specific requirements relating to push down accounting. The Accounting Principles Board (APB), in APB Opinion 16, "Busi-ess Combinations," did not address push down accounting in the separate financial statements of acquired entities. However, the literature contains principles and concepts in related areas that may be applicable to the issues raised in this paper.

APB Opinion 16

6. APB Opinion 16, "Business Combinations," establishes the principle that when an entity purchases the business of another entity, a new cost basis, based on the exchange transaction, is established for the assets and liabilities of the acquired entity in the consolidated statements of the acquirer. The Opinion also provides principles for the acquiring entity to assign values to the assets and liabilities of the acquired entity, but does not address whether those new values should be reflected in the separate statements of the acquired entity. The principles in that Opinion may have implications for the issues raised in this issues paper.

Paragraph 21 of that Opinion states:

> Reporting economic substance. The purchase method adheres to traditional principles of accounting for the acquisition of assets. Those who support the purchase method of accounting for business combinations effected by issuing stock believe that an acquiring corporation accounts for the economic substance of the transaction by applying those principles and by recording:
>
> a. All assets and liabilities which comprise the bargained cost of an acquired company, not merely those items previously shown in the financial statements of an acquired company.
>
> b. The bargained costs of assets acquired less liabilities assumed, not the costs to a previous owner.
>
> c. The fair value of the consideration received for stock issued, not the equity shown in the financial statements of an acquired company.
>
> d. Retained earnings from its operations, not a fusion of its retained earnings and previous earnings of an acquired company.
>
> e. Expenses and net income after an acquisition computed on the bargained cost of acquired assets less assumed liabilities, not on the costs to a previous owner.

FASB Discussion Memorandum

7. In its 1976 Discussion Memorandum on "Accounting for Business Combinations and Purchased Intangibles" (pages 114 to 116), the FASB raised the following implemental issue:

> IMPLEMENTAL ISSUE THIRTEEN: Should a new accounting basis recognized for a constituent company in a combined enterprise's financial statements also be recognized in any separate financial statements of the constituent company?
>
> For a number of reason (e.g., the existence of minority interests or financing arrangements with others),

a constituent company may need to issue separate financial statements at the time of, or subsequent to, a combination. Also, resolution of Implemental Issue Eleven concerning disclosures for combinations that give rise to a new accounting basis may call for presentation of separate financial statements or summaries of a constituent company. APB Opinion No. 16 is silent about whether a new accounting basis for a constituent company's assets and liabilities recognized in a combined enterprise's financial statements should also be recognized for those assets and liabilities in separate financial statements of the constituent company.

8. Related questions to be addressed were presented as follows:

If a new accounting basis is to be recognized in any separate financial statements of a constituent company, the balance sheet would presumably be restated to reflect the parent company's cost, including any goodwill recognized in the combination. Likewise, the income statement would be restated to show depreciation, amortization, and other charges or credits based on the parent company's cost. Additional questions that need to be addressed if a new accounting basis is to be recognized in a constituent company's financial statements include:

1. Should that accounting treatment apply to a combinee that has significant minority interests after the combination?

2. If so, how should amounts be assigned to identifiable assets and liabilities, minority interests, and to goodwill in those financial statements?

3. Should the stockholders' equity section be restated to recognize retained earnings only for periods subsequent to the combination?

4. What special disclosure should be provided in those financial statements (e.g., the accounting basis followed, the parent company's ownership percentage, and legally available retained earnings)?

Resolution of these questions and others would presumably be influenced by how the related issues concerning a combined enterprise's financial statements are resolved. Specifically: Implemental Issue Nine addresses special measurement problems in a combined enterprise's financial statements where minority interests in the combinee remain; Implemental Issues Eleven and Twelve address financial disclosures and presentation for a combined enterprise's financial statements in which a new accounting basis is recognized for one or more of the constituent companies. Accordingly, respondents to this Memorandum are urged to respond to the above questions in the light of their responses to those related issues.

> If a new accounting basis is not to be recognized, the only additional question that may need to be addressed is: What special disclosures should be provided? Possibilities include the accounting basis followed, the parent company's ownership percentage, and a summary of the amounts for the separate company used in the combined enterprise's financial statements.

The FASB has deferred consideration of the Discussion Memorandum until further progress has been made on its conceptual framework project.

<u>AICPA Technical Practice Aids</u>

9. The AICPA's Technical Practice Aids, which provide non-authoritative examples and commentaries on accounting issues, addressed the issue concerning the accounting basis for assets of an entity acquired in a business combination in the separate financial statements of the entity. The inquiry and response were, however, later deleted from the Technical Practice Aids. They are included here only to illustrate the type of question raised in practice because of the absence of authoritative literature in this area. The following are the inquiry and the response:

> <u>Inquiry</u>--A company was acquired which has real estate properties whose value is in excess of

the recorded historical cost. In the negotiations for the acquired company, the individual assets were assigned specific prices. After the acquisition, the acquired company continued as a separate entity. The acquired company has various bond and mortgage debt outstanding with restrictions as to the amount of dividends that can be paid out of the net income of the acquired company.

What is the proper reporting to the mortgage and bondholders with respect to the separate statements of the acquired company, inasmuch as the borrowing agreements do provide for separately audited statements? In these statements, should the properties of the acquired company continue to be reported at their historical cost basis prior to the acquisition date, or is it appropriate to restate the asset values based on the price paid by the acquiring corporation?

If the reporting on the separate statements of the acquired company is to continue at the old historical cost basis, how can confusion in the minds of the lenders be avoided when they compare the income figures in the separate company statements with the income figures of the consolidated parent group?

Reply--Paragraph 17 of Accounting Principles Board Opinion No. 6 states, "The Board is of the opinion that property, plant and equipment should not be written up by an entity to reflect appraisal, market, or current values which are above cost to the entity." This statement is not intended to change accounting practice followed in connection with quasi-reorganizations or reorganizations. The acquisition of a company by another company would not by itself constitute a "reorganization." It would not be proper to restate the assets in the financial statements of the acquired corporation.

If there is any likelihood that financial statements based on cost to the acquired company and financial statements of the same operation based on cost to the parent company were being prepared for distribution to others (and if an auditor's opinion is expressed, such distribution should be assumed)., it would appear necessary to footnote one of the financial statements to indicate that other statements were being prepared on a different basis. It would be more appropriate to prepare such a footnote for the financial statements of the acquired company.

Montgomery's Auditing

10. Montgomery's Auditing, discusses the acceptability of the push down theory as follows (page 692 of the Ninth Edition, published 1975):

> Traditionally, a company was acquired and thereafter retained forever, sold as a unit to a third party, or liquidated. Goodwill was assumed to be an asset solely of the acquiring or parent company. Financial statements of the acquired company were on a separate company basis and remained the same (on its books) as before the acquisition. Revaluation of the assets acquired and determination of the parent's portion of goodwill arose only in consolidation and goodwill was recorded in a consolidating entry reflecting that the parent's investment in the acquired company exceeded the reported net book value of the company. When the subsidiary was sold, the goodwill disappeared from the consolidated balance sheet along with the net assets of the subsidiary, and gain or loss thereon was computed and recorded. The theoretical problems of minority interests in good will were ignored.
>
> Those problems cannot be ignored if an interest in a subsidiary is sold in a public offering or for any other reason the subsidiary is required to present separate financial statements. It is impossible to ignore the fact that a transaction has taken place, establishing a new basis of accountability, whenever a business is sold or acquired in an arm's-length transaction, even though nothing has occurred within the entity itself to warrant a new basis of accountability. The occurrence of a sale and purchase, rather than internal changes or lack of them, must be the basis for recording changes in cost. The abrupt revaluation of assets, of course, affects comparability of the net income stream of the acquired entity, but it is preferable to ignoring the accounting result of changed ownership.
>
> The principle of recording asset values and goodwill in the accounts of a company to reflect the purchase of its stock by another entity or group of stockholders has been called the "push-down" theory. At present,

> the question of how far it should be carried is unanswered...Until all of the ramifications of the push-down theory are fully explored, we would prefer to see its implementation limited to 100% (or nearly 100% - the pooling theory's 90% would be a good precedent) transactions.

Securities and Exchange Commission

11. The Securities and Exchange Commission (SEC) has no published guidelines on push down accounting. However, in some circumstances it has permitted or required push down accounting in financial statements filed with the SEC. In 1972, the SEC staff considered, but did not issue, a draft Accounting Series Release on "Accounting for Changes in Corporate Ownership." The draft release would have prescribed accounting for the transfer of the ownership of a division, subsidiary, or other component of a business entity to new owners or for a substantial change in the ownership of an entire business. The draft release stated:

> It is a well-established principle of accounting that when a corporation is purchased by another, cost based accounting requires that the cost paid by the new stockholder be the basis of accountability in financial statements reflecting the new stockholder's position. Accounting Principles Board Opinion Nos. 16 and 17 describe the acceptable method of allocating cost to particular assets in such a situation.
>
> This principle is also applicable to situations where the purchaser of a corporation or a segment of a corporation is not a single corporate entity but is a stockholder group. Where the ownership of a corporation is sold, a new basis of accountability arises based on the sale price. Sale price in such a situation

> would normally represent the price paid by acquiring shareholders less the cost of registering and issuing equity securities as set forth in paragraph 76 of APB 16....
>
> In the absence of evidence to the contrary, the sale of more than 50 percent of the common stock within a twelve month period should lead to a presumption that a change in ownership has occurred. The facts of the case must govern, however. For example, the existence of voting preferred stock, preferred stock with a participation in profits, convertible securities or other situations in which ownership is not reasonably measured by the common stock alone may require adjustment of the normal criterion. When a change in ownership occurs as a result of a sale of less than all the common stock of an entity, the new accounting basis should apply to all assets and liabilities and cost should be measured by the sales price adjusted to reflect the transaction as if all the common stock had been sold.
>
> Change in ownership which does not occur as a result of a sale does not give rise to a new basis of accountability, since no transaction has occurred nor has a cost been incurred. Hence, a spinoff of the distribution of shares or assets as a dividend to current stockholders would not represent an event which would call for a new basis of accounting.

PUSH DOWN ACCOUNTING IN PRACTICE

12. Some companies, both private and public, have applied push down accounting while others have not in apparently similar circumstances. Examples in which push down accounting were and were not applied are presented in the appendix to this paper. The division believes that there are more examples, but has not found them. If there are more, they more than likely involve private companies whose financial statements are not readily available for general distribution and constituents of consolidated groups

that do not file separate entity financial statements. Accordingly, the results of a NAARS search proved inconclusive. The examples appearing in the appendix to this paper were the most recent examples found and are summarized below.

Name of Company	Source of Information	Type of Transaction
Companies Applying Push Down Accounting		
Hughes Tool Company	1972 Form S-1 Registration 1973 and 1974 Forms 10-K	Secondary Public Offering
Virginia International Company	1977 Form 10-K	Merger
The Anaconda Company	1977-Form 10-K	Merger
Dixilyn Corporation	1977 Annual Report	Purchase
Armour and Company	1975 Form S-1	Merger
Verex Corporation	1978 Annual Report	Purchase and Merger
Hyatt Corporation	1978 Annual Report	Tender offer to go private
Companies Not Applying Push Down Accounting		
Marcor, Inc.	1975 Annual Report 1978 Form 10-K	Tender offer leading to purchase
UOP, Inc.	1975 Annual Report	Tender offer leading to purchase
Filtrol Corporation	1978 Annual Report	Tender offer lead to a purchase

ISSUES

Basic Issue

13. The basic issue to be addressed is whether there are circumstances in which push down accounting should and should not be required or prohibited.

Arguments for Push Down Accounting

14. Some believe that a new basis of accounting for an entity should be required following a purchase transaction in the voting stock of the entity that results in a substantial change in the ownership of its outstanding voting stock. They view the transaction as essentially the same as if the new owners had purchased the net assets of an existing business and established a new entity to continue that businesss. They believe that reporting on a new basis in the separate financial statements of the continuing entity would provide information that is more relevant to financial statement users. They contend that in the transaction in which a change of ownership has occurred, the acquiring entity's basis should be imputed to the acquired entity.

15. Some of the arguments in support of that view are summarized as follows:

- When there is a substantial change in ownership, the price paid for their interest by the new owners is the most relevant basis for measuring the assets and liabilities and results of operations of the entity from the perspective of the owners and should be reflected in the entity's financial statements.

- The substance of transactions resulting in substantial changes in ownership is the acquisition by new owners of an existing business, and the transactions should be accounted for as such. Those transactions are the same as if the new owners purchased the net assets of an existing business and established a new entity to continue the business.

- Under APB Opinion 16, a business purchased in a business combination is required to be stated in consolidated financial statements at the basis established in the transaction. Therefore, to achieve symmetry, the separate financial statements of the acquired entities should be presented in the same manner.
- FASB Statement No. 14 requires that separate segment information reflect the parent's cost basis for each segment. Although not every subsidiary is a segment, to achieve symmetry the separate financial statements of the acquired entities should be presented in a like manner. Issuing separate financial statements on a basis other than push down could result in the distribution of some conflicting financial information for the same segment or subsidiary.

Arguments against Push Down Accounting

16. Some believe that substantial changes in the ownership of an entity's outstanding stock should not result in a new basis of accounting for an entity in the separate financial statements of the entity and that those statements should retain the existing accounting basis. They believe that transactions in an entity's stock should not affect the entity's accounting under any circumstances.

17. They believe that a change in ownership of an entity does not establish a new accounting basis in its financial statements under the historical cost accounting framework. Since the reporting entity did not acquire assets or assume liabilities as a result of the transaction, the recognition of a new accounting basis based on a change in ownership, rather than on a transaction on the part of the entity, is undesirable under the historical cost framework. If changes in ownership were to trigger a new accounting basis, several implementation problems would arise, such as that minority interests would not have meaningful comparative financial statements. Furthermore, they observe that the entity may have entered into credit or other agreements with others, with terms related to financial statements or other financial data prepared on the existing accounting basis. Restatement of the financial statements to recognize a new accounting basis could create

problems in determining or maintaining compliance with various financial restrictions under those agreements or in calculating amounts that are based on income before income taxes, net income, or other financial data. Also, restatement could cause difficulties in comparing the entity's financial data with those for prior periods, although financial statements for prior periods prepared on a pro forma basis to give retroactive effect to the new accounting basis could help provide comparable data.

18. Some of the arguments against push down accounting are summarized as follows:

- Transactions of an entity's stockholders are not transactions of the entity and should not affect the entity's accounting.
- A new basis of accounting would be detrimental to interests of holders of existing debt and non-voting capital stock who depend on comparable financial statements for information about their investments and do not have access to other financial information. Push down accounting would affect the ability of the entity to comply with debt covenants required by outstanding debt and would materially alter the relationships in the entity's financial statements. When minority owners and other investors are entitled

to financial statements, those financial statements should be prepared based on transactions of that entity and not transactions of stockholders.

- FASB Statement No. 14 deals with reporting information on segments of a business and is irrelevant to push down accounting.
- There is no logical way to establish limits for determining which owner's transactions should qualify for push down accounting.

Factors That Alter Views on Acceptability

19. Views on the acceptability of, and arguments for and against, push down accounting differ depending on whether the entity has outstanding debt held by institutional lenders or held by the public and on whether the entity has outstanding a senior or nonvoting class of capital stock that is not involved in the transaction. Views and arguments also differ depending on whether the transaction involves a 100% change in the ownership of the voting stock of an entity or less than a 100% change, leaving a minority interest in the voting stock of the entity.

Corporate Acquisitions Versus Acquisitions by Others

20. Some view changes in ownership that involve corporate acquisitions differently from changes in ownership that involve acquisitions in which either or both of the entities are not corporations. Others believe that the same principle should

apply to all types of major changes in ownership. In rare situations, however, the cost basis of an unconsolidated investor is not known and cannot be determined. For example, an individual who purchases 90% of the stock of an entity may not wish to divulge his purchase price.

Existence of Institutional Debt and Senior Class of Stock

21. A new basis of accounting would raise some questions if an entity has outstanding debt, held either by institutional lenders or the public, or another class of capital stock. For outstanding debt, the considerations differ for debt held by institutional lenders, such as banks, and for debt held by the public. Some believe, for example, that institutional lenders depend less on comparable financial statements than public holders of debt securities. Some also argue that public holders of debentures issued under an indenture have some expressed or implied quasi-equity rights in the entity that may be affected by a new basis of accounting for the entity in its separate financial statements.

22. Different considerations may apply to an entity with a class of capital stock outstanding that is senior to its voting capital stock. Complex relationships and contingent rights may exist that should be considered. For preferred stock with a fixed dividend requirement, for example, a new

basis of accounting in the separate financial statements of the entity would affect the computation of dividend coverage in a manner that may be unacceptable to the holders of the stock.

Less Than a 100% Change in Ownership

23. A substantial change in the ownership of an entity that involves less than 100% of its outstanding voting stock raises questions relating to the level at which a change in the ownership of an entity should be deemed to have occurred. In addition to the considerations discussed in paragraphs 21 and 22 there may be other considerations in a less than 100% change in ownership because of minority interests.

The questions that should be considered include

a. What should be the threshold level of a change in ownership for a new basis of accounting? Or, conversely, how large a minority interest may exist after the transaction and still use push down accounting?

b. How should amounts be assigned to the identifiable assets, minority interest, and goodwill in the separate financial statements of the entity?

24. Views on the percentage level of ownership change for which a new basis of accounting should be considered vary. Some believe that substantially all (90%, the percentage re-

quired for a business combination accounted for by the pooling of interests method in APB Opinion 16) should be the threshold level. Others believe that the threshold percentage level of ownership change should be at least 80%, the percentage level specified for various tax treatments under present tax law. Some believe that the threshold level of ownership change should be 51%, the percentage ownership generally required for control and for subsidiary accounting, under ARB No. 51.

25. Views also differ on the method of assigning values to identifiable assets and liabilities, minority interest, and goodwill in the separate financial statements of the entity. This issue is not peculiar to push down accounting. Some believe that values should be assigned based on the market value of the entity as a whole imputed from the transaction. To illustrate, if 60% of the ownership interest in an entity changed hands at a price of $12 million, the market value of the entity should be imputed to be $20 million and values should be assigned on that basis. Others believe that values should be assigned based on the proportional interest that changed hands. They believe that new values should be reflected in the entity only to the extent of the price paid in the transaction. They believe that the

approach is consistent with APB Opinion 16 and with the historical cost framework of accounting in that only the actual transaction would be reflected in the new basis. To illustrate, if 70% of the ownership interest of an entity changed hands at a price of $10 million, the basis of the entity's assets would be adjusted proportionally by the difference between the price paid ($10 million) and the book value of a 70% interest in the entity.

Changes of Ownership in Step Transactions

26. The acquisition over time in accordance with a plan to acquire a sufficient number of shares of an entity's voting stock to constitute a "change in ownership" raises an implementation issue concerning the method of applying push down accounting in those circumstances.

a. If changes in ownership are deemed to require a new basis of accounting, should the principle apply to a change that occurs over time in a series of steps in accordance with a plan?

b. If the principle should apply to step transactions, how should the new accounting basis be established?

27. Those who believe that changes in ownership should require a new basis of accounting also believe that a change that occurs

in a series of steps should follow the same principle. The arguments for and against that view are the same as the general arguments for and against push down accounting.

28. Views vary on the method of establishing a new accounting basis as a result of a change in ownership that occurs in a series of steps. Some believe that the new basis should represent the sum of the amounts paid by the new owners in each of the steps in the series. They argue that each acquisition should be evaluated separately because each acquisition is a distinct, measurable event. They believe that the approach is consistent with APB Opinion 16 and in accordance with the historical cost framework of accounting. Others believe that the new accounting basis should represent the valuation of the entity established by the final significant transaction in the series. They believe that the objective is to reflect the economic value of the assets to the entity at the time the change in ownership is completed. Another view is that the new basis should represent the valuation of the entity established by the first transaction in the series. To illustrate, if 20% of an entity's stock is acquired in accordance with a plan to acquire in a series of steps 80% of the entity's stock, a new basis would be established based on the imputed value of the entity from the sales price of the 20% interest.

When the Acquired Entity is Merged into an Affiliated Entity Other Than its Parent

29. In some cases an entity may arrange for a wholly owned subsidiary, usually a newly incorporated or shell corporation, to complete an acquisition by paying the consideration, sometimes the parent's common stock, and receiving the acquired entity's assets and liabilities. There are differing views concerning the accounting for the transaction by the subsidiary. Some believe that whether a parent acquires an entity or causes an affiliate to acquire an entity, the economic substance is identical. In that regard, some believe that push down accounting applies, while others believe that APB Opinion 16, "Business Combinations," applies (the application of either achieves the same result). Still others believe the economic form rather than the economic substance should be the determining factor and view the two distinct transactions as not requiring the application of push down accounting or of APB Opinion 16.
16.

Allocating the New Cost Basis to the Acquired Entity's Assets and Liabilities

30. Some proponents of push down accounting believe paragraphs

67, 68, 87 and 88 of APB Opinion 16, which discuss how an acquiring entity should allocate the cost of an acquired entity to the assets acquired and the liabilities assumed for consolidated financial statements, should also apply to an acquired entity in allocating such cost in its own financial statements.

Spinoffs and Splitoffs

31. Spinoffs and splitoffs involve changes in the form of ownership. Spinoff and splitoff transactions are nonreciprocal transfers in which a corporation distributes assets to its stockholders in partial liquidation. That view is expressed in APB Opinion 29 in which those types of transactions are exempt from the measurement principles required for nonmonetary exchanges. The SEC's draft release, referred to in paragraph 11 of this paper, describes a spinoff as a change in ownership that does not occur as a result of a sale. For that reason, a spinoff was not deemed to give rise to a new accounting basis. Some however view those transactions as exchanges in which the stockholders surrender a part of their ownership interest in the corporation for an interest in another corporation. Others believe, however, that though the transactions may be exchanges as to the stockholders they are not exchanges as to the corporation. Also, in many spinoff and splitoff transactions a market value for the transactions can be readily determined. Therefore, an issue

that should be considered is whether an entity involved in a spinoff or splitoff should report in its separate financial statements on a new basis as established in the spinoff or splitoff transaction.

Collateral Issues

32. In addition to the major issues identified, the following collateral issues should be considered if push down accounting is to be permitted or required in any circumstances.

a. If a new basis of accounting is established for an entity, should the retained earnings of the predecessor be carried forward? If not, should the retained earnings be dated?

b. What special disclosures should be presented in the entity's financial statements (for example, the accounting basis followed, pro forma information, the parent company's ownership percentage, and legally available retained earnings)?

* * * * * * * *

ADVISORY CONCLUSIONS

33. The following are the advisory conclusions of the Accounting Standards Executive Committee on the issues discussed in this paper.

a. There are circumstances in which the cost to new owners in a transaction that results in a substantial change in ownership, as in the acquisition of an entity in a business combination accounted for by the purchase method, should be imputed to the acquired entity,

1. when the acquired entity remains a subsidiary (8 yes, 5 no)

2. when the acquired entity is merged into an affiliated entity other than its parent (8 yes, 5 no)

b. A substantial change in ownership that justifies a new basis of accounting should be deemed to have occurred when there is a:

100% change (8 yes, 5 no)
At least 90% change (7 yes, 6 no)
At least 80% change (4 yes, 9 no)
At least 51% change (0 yes, 12 no)
At least 20% change (0 yes, 13 no)

c. Splitoff and spinoffs should not give rise to a new accounting basis. (13 yes, 0 no)

d. If a new basis is established in a series of step transactions, it should be consistent with the parent's basis determined under the rules for the purchase method of accounting. (12 yes, 0 no)

e. Push down accounting should be applied when substantial changes in ownership result from related market transactions in an entity's stock. The relationship can arise as a result of plans or actions of sellers, for example, a secondary public offering, or of purchasers, for example, individuals acting in concert. (10 yes, 5 no)

f. If a new basis of accounting is established for an entity, the retained earnings of the predecessor should not be carried forward. (15 yes, 0 no)

If retained earnings are not carried forward, subsequent retained earnings should be dated.

(10 yes, 4 no)

FINANCIAL REPORT SURVEYS *(continued from inside front cover)*

13 Illustrations of the Disclosure of Unaudited Financial Information in Audited Financial Statements (1977)*

14 Illustrations of Accounting for Employee Benefits (1977)*

15 Updated Illustrations of Accounting Policy Disclosure (1978)*
A survey of applications of APB Opinion No. 22

16 Illustrations of Accounting for Leases (1978)*
A survey of the application of FASB Statement No. 13

17 Illustrations of Accounting for Debt Under Four Pronouncements (1978)*
A survey of the application of APB Opinion No. 26 and FASB Statement Nos. 4, 6, and 15

18 Illustrations of Auditor's Reports on Comparative Financial Statements (1979)*
A survey of the application of SAS No. 15

19 Illustrations of Management Reports on Financial Statements (1979)*
A survey of the application of the conclusions and recommendations of the AICPA Special Advisory Committee on Reports by Management

20 Illustrations of Selected Proxy Information (1979)*
A survey of the application of SEC requirements to disclose auditors' services and management perquisites in proxy statements

21 Illustrations of Accounting for Joint Ventures (1980)
A survey of the application of various methods of accounting for joint ventures in the financial statements of venturers

22 Illustrations and Analysis of Disclosures of Pension Information (1981)
A survey of the application of the requirements of FASB Statement No. 36, an amendment of APB Opinion No. 8

23 Illustrations and Analysis of Disclosures of Inflation Accounting Information (1981)
A survey of the application of the requirements of FASB Statements Nos. 33, 39, 40, and 41

24 Illustrations of Foreign Currency Translation (1982)
A survey of the application of FASB Statement No. 52

25 Illustrations of Accounting for Innovative Financing Arrangements (1982)

26 Updated Illustrations of Management's Discussion and Analysis of Financial Condition and Results of Operations (1983)
A survey of the application of recently amended Rules 14a-3 and 14c-3 of the Securities and Exchange Act of 1934 in annual reports to shareholders

27 Illustrations of Accounting and Reporting by Development Stage Enterprises (1984)
A survey of the application of FASB Statement No. 7

28 Illustrations of Accounting for Enterprises in Unusual Circumstances and Reporting on Them by Independent Accountants
A survey of • troubled enterprises • reorganized enterprises • liquidating enterprises

29 Updated Illustrations of Departures from the Auditor's Standard Report (1984)
A survey of the application of Statement on Auditing Standards No. 2, as amended

30 Updated Illustrations of the Disclosure of Related Party Transactions (1985)
A survey of the application of FASB Statement No. 57